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SUBJECT: MEXICAN BUSINESS SUMMIT TOUTS LIMITED ENERGY REFORM; ANTICIPATES THAT MEXICO CAN MUDDLE THROUGH U.S. FINANCIAL CRISIS

REF: A) MEXICO 3210; B) MEXICO 3345

MONTERREY 00000506 001.2 OF 006

¶1. Summary. Approximately 200 business leaders and government officials attended the sixth annual Mexican Business Summit in Monterrey, and they discussed energy reform, the impact of the U.S. financial crisis on Mexico, whether Mexican can increase its economic development, President Calderon' political reforms, security issues, and the bilateral relationship. Colombian President Alvaro Uribe described Colombia's efforts against drug cartels and measures taken to maintain stability in the face of the global financial crisis. Mexican Energy Minister Georgina Kessel promoted the recent energy reform, claiming that the reforms would permit the state oil company Pemex to maintain oil production, increase the use of renewable energy, and allow for private sector participation. On the margins, several private companies said that they are interested in working with Pemex. GOM Undersecretary of the Economy Felipe Duarte Olivera claimed that Mexico would avoid an economic downturn and he praised Calderon's economic reforms, while others saw the U.S. financial crisis as far more threatening to Mexico and dismissed the reforms as cosmetic. Honduran President Jose Manuel Zelaya Rosales argued that the financial crisis could be overcome through greater economic integration. Mexico was also urged to increase its focus on trade with China. End Summary.

Colombia President Uribe Preaches Success in Drug Battle; Economic Stability

¶2. Colombian President Alvaro Uribe emphasized the measures taken by his government to maintain stability during the global financial crisis. Uribe, speaking to a packed audience for over an hour and a half, maintained that only private investment coupled with social reforms could alleviate poverty. He described tax incentives used to attract foreign investment in Colombia, particularly in the energy field. According to Uribe, Colombia has sufficient dollar reserves, banks have not been exposed to high risk mortgages, and speculation in derivatives has not been a problem. Further, he was proud that his government had dismantled many subsidies over the past several years.

¶3. Despite his general confidence in the Colombian economy, Uribe noted several areas of concern. He fears a drop in

foreign investment and a loss of tax revenue resulting from global demand reduction. Many energy projects dependent on foreign capital could be postponed in his view. Uribe also condemned fraudulent pyramid financial schemes which could damage the financial sector and he vowed to prosecute those involved with such illegal financial schemes.

¶4. Uribe fielded numerous questions related to his government's success in combating organized crime and narcotrafficking. He argued that economic stability required public trust and that such trust emerged from a secure physical environment. Uribe attributed Colombia's success against organized crime to public involvement in security programs; awards for persons identifying criminals; protection programs for crime victims; a robust extradition program; reform of the intelligence community; national control of police forces; a doubling of the justice budget; a significant coca eradication program, and zero tolerance for corruption in government. Responding to a question about the targeting of labor leaders, Uribe stated that murders in his country had been reduced from 35,000 per year to about 16,000 and that many areas, including Bogota, had become much safer. He added that success against crime required social advances, including improved education, health, labor, and tax programs.

¶5. Uribe stressed the importance of a free market capitalist system, coupled with strict regulations against wild speculation. He expressed confidence that the G-20 would address the need for reforms and promoted continued reliance on free trade agreements, including the pending agreement with the United States. Uribe expects to have some 45 trade agreements in force by 2010.

Can the Mexico's Energy Reform Maintain Oil Production?

¶6. Minister of Energy Georgina Kessel pitched Mexico's energy reform law as just the right medicine to modernize Pemex, maintain oil production, permit contracts with private industry (but not share profits), build a refinery and encourage renewable energy (see details in reftel A). Kessel claimed that the reform will encourage Pemex to continue production of 3 million barrels of oil per day `in the near term', add 1% GDP growth, create 300,000 jobs per year, and maintain revenue for the federal government, provide 26% of Mexico's electricity through renewable energy by 2012, and provide funding for the federal, state and local governments.

¶7. There was considerable skepticism whether the energy reform package could meet its goals. In a subsequent panel discussion on energy, Eugenio Laris Alanis, Director of Financed Investment projects for the Federal Commission of Electricity (CFE) described the reform as a political consensus that delivered minimum economic impact. Laris noted that oil production was declining, so in the near future Mexico could no longer export oil. Note. Kessel had claimed that Pemex could compensate for declines in existing fields by boosting deep water production, which seems optimistic since Mexico has drilled few deep water wells and these fields take years to come on line. End Note. Laris further asked how Mexico would cover the hole in government spending, since the GOM relies on oil revenue for up to 35% of its revenues. Political analyst Sergio Sarmiento questioned Kessel's job creation and GDP growth targets, stating that Pemex would have to create double its own payroll every year to meet this goal. The renewable energy goal

also appears to be a reach. Herbert Mills, Managing Director for Duke Energy's business development, privately estimated that Mexico currently produces 16% of its electricity through hydropower, adding that Mexico plans to add several more megawatts through wind energy. Mills thought that perhaps Mexico could get to 20% renewable energy, but it will be difficult to expand wind power further because the demand for wind turbines and equipment is so high that equipment is ordered years in advance.

¶8. Although many economists and commentators have blasted the energy reform law since it prohibits profit sharing contracts with private industry, in side conversations, some private companies noted their interest in production contracts with Pemex. In public, officials such as Exxon Mobil's Neal Goins blandly said that it is too early to tell if the energy reform is bold enough to attract deep water investment. However, several officials from British Petroleum told Econ MinCounselor that they saw a number of opportunities for contracts under the new law. A Monterrey energy lawyer also said that his firm is studying the law for possible investment opportunities and he was optimistic that they could be found.

Honduran President Zelaya Urges Further Economic Integration

¶9. Honduran President Jose Manuel Zelaya Rosales delivered an upbeat message grounded in his conviction that the present financial crisis will be confronted and overcome. Zelaya blamed the continuing crisis on a lack of public trust that must be restored through strengthened international regulations and the establishment of firm dates for resolving outstanding banking and financial issues.

¶10. Zelaya called for development of a financial architecture that would unite Mesoamerica in a manner similar to the European Union. He envisions the integration of the 190 million people in the region, joined through common communications, transportation and customs systems. Zelaya suggested that such integration would give the region more independence in matters of energy, food, and the economy. He informed the audience of the tax free zone in the Bay Islands of Honduras, the advantages

of the Port of Cortes, and of Honduran tax incentives for foreign investment in bio fuel production and the tourism industry.

¶11. Zelaya praised both President Calderon and President Uribe for their fight against narcotrafficking. He referred to both the drug consumption problem in the United States and the coca production problem in South America. He termed the Merida Initiative a good first step, but acknowledged that a policeman could be bribed with more narco money in one day than the government could provide in a year's salary. Despite the challenges, Zelaya said that narcotrafficking must be fought from Colombia to the US.

¶12. Zelaya's remarks were largely devote of criticisms or blame for the financial crisis or the drug situation. Instead, he emphasized the value of free trade agreements, the importance of regulating the free market system, and continued regional economic integration. He further expressed confidence in the next US administration and urged broader diplomatic relations between the US and Latin America.

Mexican Economic Ministry Describes Positive Economic Growth

¶13. Standing in for Economy Minister Ruiz Mateo, Undersecretary Felipe Duarte Olivera painted a mostly positive picture of the Mexican economy. Despite the financial crisis, Olivera cited some growth in the economy, the creation of about 375 thousand jobs this year, continued foreign investment and Mexico's infrastructure program as signs that the country will weather the financial storm. While acknowledging slowdowns in all of the above areas, Olivera maintained that Mexico was gradually moving away from the traditional effects of cyclical downturns in the U.S.

¶14. Olivera also listed advances in structural reforms accomplished during the Calderon administration. He identified pension reform and recent energy reform measures giving oil monopoly Pemex greater flexibility in contracting private firms as two primary examples of economic advances. He maintained that the government would make Small and Medium sized Enterprises the driver of Mexico's economy. Further, he described the massive road, port, and bridge construction programs as evidence of the government's determination to spend more money to expand the economy. He looked to more regional integration as a step toward greater economic prosperity.

¶15. Comment. Somewhat surprisingly, Olivera made almost no mention of current dangers to the Mexican economy: falling oil production; reduced remittances; weakened demand for Mexican exports; expected losses in the tourism industry; postponements of some infrastructure development programs; and declining foreign investment. End Comment.

Differing Views of the Seriousness of the U.S. Financial Crisis

¶16. While several foreign commentators argued that the U.S. financial crisis will fundamentally change world consumption patterns, forcing Mexico to move beyond primarily exporting to the U.S., Mexican government officials and businessmen simply saw a deep, but typical, recession, and expected U.S. consumption habits to resume after a pause. In a panel discussion of the consequences of the U.S. financial crisis, Justine Thody of the Economist Intelligence Unit said that while the typical recession affected investment, this one is much more severe since it is linked to a drop in household spending, and another panelist noted that consumption accounts for 70% of the U.S. GDP. Thody compared the U.S. crisis to the lost decade for Japan, and thought that global demand would be restructured. Eric Siegel, President of Export Development of Canada, agreed

that this would be a very deep and broad recession, and the recapitalization process would be difficult since banks were hesitant to lend any money, affecting liquidity. Clyde Prestowitz, President of the Economic Strategy Institute (of the U.S.) argued that U.S. consumption had reached its limits, and forecast a global re-adjustment because America must stop living beyond its means.

¶17. Most Mexican panelists thought that the U.S. was just suffering a downturn, and like Under Secretary Olivera, they expected things to soon return to normal. Nuevo Leon Governor

Jose Natividad Gonzalez Paras stated that President Calderon had reacted well to the crisis, and that Mexico's national infrastructure program would have a good countercyclical effect. Governor Gonzalez also thought that the crisis would bring areas of opportunity, and he promoted his long term strategy of building clusters of information technology, biotechnology, and health services to Nuevo Leon, in addition to automotive and household appliances. Governor Gonzalez also touted a well publicized plan by Nuevo Leon to combat the crisis, arguing that states could alleviate the problem, although much of his plan consists of making suggestions for actions by the federal government. In other panels several other Mexican business leaders took a similar line, suggesting that the Mexican government should react with their usual remedies of decreasing regulation and increasing financial incentives for investment (see also reftel B). None of them suggested that Mexico needed to re-examine its dependence on U.S. consumer spending. (Mexico currently exports 78% of its goods to the United States, many of them bulky consumer items).

Mexico is Not Poised to Become a BRIC country

¶18. According to several panelists, Mexico is not making the fundamental changes required to become a high growth BRIC (Brazil, Russia, India and China) country. The discussion was kicked off with a Goldman Sachs study predicting that Mexico would become the fifth largest economy in the world by 2050 and that Mexico and Korea were becoming BRIC countries in terms of economic growth. Guillermo Prieto Trevino, President of the Mexican stock market, dissented stating that the BRIC countries are making fundamental reforms to improve competitiveness and labor productivity, but Mexico is not. Indeed, Mexican income levels are actually declining relative to the United States. Axel van Trotsenburg, World Bank Director for Mexico and Colombia, pointed out that before Mexico's income was 33% of the U.S., but now it has declined to 25%, while Korea and Chile are showing marked improvement. Moreover, the Mexican educational system has fallen behind, as Mexican students have the lowest marks in the OECD countries, while Korea had an outstanding educational system. In addition, Mexico only devotes 1% of its GDP to research and development, while China spends 3% on R&D. Mexico also ranks poorly in studies of international competitiveness and regulatory burden on businesses. The Mexican people still have a low rate of financial intermediation, 30% of banking assets to GDP compared to Brazil at 80%. Pedro Garcia, Managing Partner of Accenture, made the interesting point that in Brazil President Lula convinced the Brazilian people that to become a world player Brazil had to make enormous changes, and they have done so.

Greater Trade With China as a Solution?

¶19. The conference opened with a discussion of the economic relationship between Mexico and Asia, with an emphasis on China. Hong Kong businessman Chen Yuming encouraged a much stronger Mexican effort to address the current trade imbalance with China. He urged the Mexican government to actively promote quality goods and services in China. Saying that China had some USD 7-8 trillion dollars in reserves, Chen advocated for more Mexican trade in architecture, food, cultural and other products unique to this country. Chen also noted that Mexico should take greater advantage of its position as the gateway to the U.S.

¶20. Chen stated that three of the 10 largest Chinese auto

manufacturers currently maintain investments in Mexico and 4 more companies are considering establishing production here. When asked how this could be happening at a time when the auto industry is under stress, Chen viewed the financial crisis as a passing phenomenon, stating that Chinese companies sought to be in a strong position to serve the US auto market when economic conditions improve.

¶21. Several speakers promoted a comprehensive trade agreement between China and Mexico and some commented on the importance of Japan, Malaysia, Vietnam, and other Asian markets as essential to further diversification of Mexican global trade. Note. Mexico has free trade agreements with over 40 countries, but 78% of its exports are still destined for the American market. End Note.

Mexico's Political System produces Tepid Economic Reforms

¶22. Several prominent political commentators agreed that Mexico's political system produces minimal economic reforms that cannot transform the country. Political commentator Denise Dresser described Calderon as a pragmatic minimalist, who thinks small so reforms are diluted. Dresser castigated the Mexican political class for celebrating political consensus, such as on energy reform, which does not solve the problem. Political analyst Sarmiento agreed that the energy reform was a political success for Calderon, especially since it divided the leftist opposition PRD party, but questioned whether the reforms would result in increased oil production. Sarmiento commented that the ISSTE pension reform was the best reform, the fiscal reform only met a small part of the needs, and the energy reform was primarily a political success. In contrast, in a panel discussion on increasing Mexico's internal market, several speakers mildly praised Calderon's reforms as a step forward and improving competitiveness. Similarly Alfonso Zarate Flores, CEO of Grupo Consultor Interdisciplinary, acknowledged weaknesses in the Calderon reforms, but he put them in the context of the evolution of the Mexican political system, so there are political checks on the Mexican President, who can no longer dictate reforms.

Security Battle

¶23. Although Mexico remains a major drug transshipment country, there have been significant successes in the war on drug cartels. Jorge Chabat, Professor at the Economic Education and Study Center, maintained that the Mexican Government military offensive against the drug cartels and extradition of key narcotics traffickers has fragmented the cartels and increased Calderon's popularity, albeit at the price of much higher violence. Chabat also said that the GOM had improved its intelligence systems, and cited the Merida Initiative as an example of the increased level of trust with USG law enforcement. Monte Rubido Garcia, executive secretary for the National System of Public Security, claimed significant advances in the fight against drug cartels, citing the arrest of drug kingpins, seizures of cocaine, money and arms, and attributed these successes to better intelligence work. Despite these advances, much remains to be done. Rubido Garcia acknowledged that citizens are reluctant to report crimes, since the police forces were originally designed to control the population, not to protect the people. A questioner described Mexico as having a culture of impunity, beginning with black market goods and extending to police corruption.

¶24. In spite of the diagnosis, there were few real suggestions

how to change Mexico's culture of impunity or improve the police forces. For example, Thody of the Economist Intelligence Unit stated that Colombia substantially improved its police force through higher salaries financed through higher taxes, but no one responded that they were willing to pay more taxes for a more effective police force. Instead the panel ended with comfortable platitudes that all Mexicans are in this together

and we must improve the culture of lawfulness in Mexico.

U.S. Priority will be the U.S. Economy; Immigration Reform will Wait

¶25. Panelists forecast that President-elect Obama would principally focus on the U.S. economy and mark time on immigration reform. James Kolbe, former U.S representative and current senior fellow with the German Marshall fund, thought that President-elect Obama would need to focus first and foremost on the U.S. financial crisis. Roger Wallace of the Mexico Center in the Woodrow Wilson Center agreed that Mexico would not be a priority, but other panelists pointed out that this is positive, because the bilateral relationship was strong. The panel generally agreed that with rising unemployment, Obama would not be able to tackle immigration reform in the first two years of his presidency. However, it is also possible that the issue could bubble up through pressure from Congress. Several speakers also praised the Merida Initiative as symbolic of the shared responsibility to confront the problem of drug cartels.

¶26. Comment. Although the 2008 Mexican Business Summit had headliners such as Colombian President Uribe and Mexican Energy Secretary Kessel, the Mexican Government representation was lower level. President Calderon made presentations at the 2006 and 2007 Summits, Treasury Secretary Carstens spoke at the 2006 Summit and Central Bank President Guillermo Ortiz in 2007. In Econoff's view, the summit mood also shifted. In 2006 there were great expectations for the Calderon Administration, and President-elect Calderon promised that Mexico would become the best place in the world for foreign investment. In 2007, business leaders were frustrated that President Calderon had not enacted the fundamental structural economic reforms needed to lift Mexican international competitiveness. In the 2008 edition, although there were calls to improve Mexican economic competitiveness and enhance security, the Mexican attendees seemed less demanding and accepted that Mexico had taken the first steps on reforms and would ride out the U.S. financial crisis. End Comment.

¶27. This cable was drafted collaboratively between the Embassy in Mexico City and the Consulate General in Monterrey.
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